LOWELL WEICKER, JR., CONN., CHAIRMAN
BOB PACKWOOD, OREG.
ORRIN G. HATCH, UTAH
S. I. HAYAKAWA, CALIF.
RUDY BOSCHWITZ, MINN.
SLADE GORTON, WASH.
DON NICKLES, OKLA
WARREN RUDMAN, N.H.
ALFONSE M. D'AMATO, N.Y.
SAM NUNN, GA.
WALTER D. HUDDLESTON, KY.
DALE BUMPERS, ARK.
JAMES R. SASSER, TENN.
MAX BAUCUS, MONT.
CARL LEVIN, MICH.
PAUL E. TSONGAS, MASS.
ALAN J. DIXON, ILL.
ROBERT J. DOTCHIN, STAFF DIRECTOR
R. MICHAEL HAYNES, CHIEF COUNSEL
ALAN L. CHVOTKIN, MINORITY CHIEF COUNSEL

United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

March 8, 1982

Honorable Pete V. Domenici
Chairman
Senate Budget Committee
Washington, D.C. 20510

Dear Mr. Chairman:

As required by Section 301 (c) of the Congressional Budget Act of 1974, attached is the report from the Committee on Small Business on its recommendations for programs and policies under its jurisdiction.

Sincerely,

SAM NUNN
Ranking Minority Member

LOWELL WEICKER, Jr.
Chairman

Attachment

5722-3

REPORT OF THE COMMITTEE ON SMALL BUSINESS PURSUANT TO SECTION 301(c) OF THE BUDGET ACT OF 1974

It is the firm conviction of the Senate Small Business Committee that the success of the American economy is critically dependent upon the preservation of real opportunity for small business. Every effort must be undertaken to preserve and strengthen the small business segment of our economy. Despite all of the mounting economic hardships, small business still accounts for 90 percent of the new jobs created in the private sector. Small firms still account for 38 percent of the gross national product, and for nearly half of the Nation's industrial innovations. If the small business economy of the Nation suffers, the American economy as a whole fails. Specifically, in order to realize the national goal of economic recovery, the small business community needs:

- an economic environment conducive to the creation, development, growth and survival of small businesses;
- an adequate supply of capital that is available to small businesses and at reasonable rates;
- a reduction in the concentration of economic power and an increase in the level of competition within the American economic system; and
- a coordination of Federal policies, programs, regulations and activities to assure the recognition and protection of the economic interests of small businesses by the Federal Government.

The Committee firmly believes that the Small Business Administration is uniquely qualified to serve the needs of small business. Through continued, aggressive oversight of the Small Business Administration and its programs, the Committee has established a priority agenda to insure that the SBA manages its programs efficiently and effectively. Needed reforms have already been seen in the management of SBA's programs. It is the Committee's expectation that as the oversight activities continue, the SBA will become a better advocate for the small business community.

RECONCILIATION

Consistent with the effort to reduce spending in this Congress, the Small Business Committee, through the Reconciliation process, passed cost-saving legislation that reduced the Small Business Administration's program levels by 40 percent.

The bill which emerged from the House/Senate Conference, and was enacted into law, was a carefully drafted piece of legislation designed to reallocate limited resources, established clear priorities, and set a new direction for the Agency.

The bulk of the spending reductions were made in the lending programs, in accordance with the Committee's desire to shift the program emphasis of the Agency away from individual loan making, to more cost-beneficial programs. Additional reductions were made in disaster assistance. Accordingly, the "503" program, which promotes economic development through a public/private funding partnership, the Small Business Development Center program, and the Guaranteed Lending program, were all preserved.

By refocusing the activities of the SBA in this manner, the Committee believes that dollar for dollar, more jobs will be created, greater expansion of healthy businesses will be undertaken, and more help will be directed where it is really needed. Ultimately, the Committee believes these structural changes will make the SBA a stronger, more effective Agency.

The Committee firmly believes that the legislative foundation established last year should be the basis for its recommendations in Fiscal Year 1983 and beyond.

SALARIES AND EXPENSES

The Committee recommends that the level of $225.4 million for salaries and expenses be approved for Fiscal Years 1983 through 1987. This figure represents a slight increase over current law to insure adequate funding for certain non-lending programs at the Agency which have a high priority for the Committee, and the Congress. This level also assumes that business development expenses will continue to be funded from the Business Loan and Investment fund.

The Committee is particularly interested in maintaining the level of management assistance provided small businesses in Fiscal Year 1982. One of the predominant causes of small business failures is the lack of basic management and technical skills. SBA, through its own management assistance staff, and in coordination with its private sector partners (including universities, SCORE volunteers, and private consultants), should continue to aggressively provide this needed advice and counsel to small firms. Any retrenchment in funds or resources in this endeavor would only result in fewer businesses being served, more bankruptcies, and greater unemployment. Therefore, the Committee specifically recommends that the current law level of $28.3 million for management assistance be maintained.

The Committee also recommends that $12 million be made available to fund the existing 19 state Small Business Development Centers. As the SBA notes in its "budget estimate", the Small Business Development Center program is "considered the prototype for management assistance delivery system of the future." The Committee believes that $12 million will be needed in Fiscal Year 1983 to effectively continue the second year of the four-year statutory program test to determine whether the combined use of university, federal, state and private sector resources, is successful in meeting the management needs of small businesses.

DISASTER REVOLVING FUND

The Small Business Administration's disaster lending programs were significantly revised in Reconciliation (P.L. 97-35). Through the major legislative revisions noted below, the Congress was able to achieve substantial budgetary savings:

1. Disaster Loans - Credit Elsewhere Test

   The credit elsewhere test, which previous law applied only to business disaster loan applicants and solely to determine interest rates (but not eligibility), was extended to homeowners as well, but solely to determine the interest rate applicable on a disaster loan.

2. Disaster Loans - Interest Rate for Homeowners

   The interest rate for homeowners unable to obtain credit elsewhere was set at one-half the cost of money to the Federal Government for comparable length Federal borrowings, plus up to 1 percent at

SBA's discretion, but not to exceed 8 percent. The rate for homeowners able to obtain credit elsewhere is set at the full cost of money to the government, plus up to 1 percent.

Prior law set the disaster loan interest rate for all homeowners for repair of a primary residence at 3 percent on the first $55,000 of assistance.

3. Disaster Loans - Rates for Businesses Without Credit Elsewhere

Interest rates for businesses unable to obtain credit elsewhere was set at an interest rate not to exceed 8 percent. Prior law set the interest rate at a flat 5 percent.

4. Disaster Loans - Rates for Businesses With Credit Elsewhere

The Administrator of SBA, after discussion with the Secretary of Agriculture, is authorized to set the rate of interest for businesses able to obtain credit elsewhere, but not to exceed the rate prevailing in the private market and not to exceed the maximum rate for guaranteed loans as determined by SBA pursuant to section 7(a) of the Small Business Act. In addition, the maximum term of these disaster loans is limited to three years.

5. Nonphysical Disaster Loans

Prior law established seven categories of nonphysical disaster loans (including regulatory compliance, product disaster, economic dislocation, and water pollution control). Under present law these eight programs have been combined into a new "Federal action" disaster loan program. However, the Reconciliation law expressly provides that there will be no funds authorized in Fiscal Years 1982-1984 for this program.

6. Farmer Eligibility at SBA

Agricultural producers are generally fully eligible to apply for and receive SBA assistance. However, if the assistance being sought is a disaster loan, the farmer must be declined for or would be declined for emergency loan assistance at substantially similar interest rates from the Farmers Home Administration.

The Administrator of SBA and the Secretary of Agriculture are expected to consult and establish substantially similar interest rates for credit worthy and non-credit worthy borrowers. The statutory language approved for the Small Business Administration conforms with that adopted by the Agriculture Committee's Conferees with respect to disaster assistance from Farmers Home Administration to insure that farmers seek disaster assistance first from FmHA.

Although the existing law does not specify an annual program level, it is anticipated that a significant appropriations reduction from the previous year's level will occur. These estimates, based on a "normal" disaster year, indicate budget authority of 0 and outlays of $440 million for Fiscal Year 1983.

SURETY BOND GUARANTEES PROGRAM

Small business contractors and subcontractors who seek public (and some private) construction jobs are often required to furnish surety bonds. Through its Surety Bond Guarantee program, SBA can assist such contractors by extending a guarantee to a surety of up to 90 percent against loss in order to make bonding more easily obtainable. Bid bonds as well as payment and/or performance bonds may be guaranteed on contracts of up to $1,000,000. SBA may guarantee up to 90 percent of bonds less than $250,000 and up to 80 percent of bonds from $250,000 to $1,000,000. SBA may also pay a surety up to 10 percent of the value of the contract in order to prevent a breach of that contract when such a breach is imminent.

SBA does not directly bond a contractor. If small contractors need a surety bond, they contact their agents and apply for a bond by providing various background, credit, and financial information required by the surety company. The agent submits this underwriting information to the surety company which decides whether to execute the bond with SBA's guarantee. Surety companies eligible to receive SBA's guarantees must be included in the U.S. Treasury Department's list of qualified sureties.

If the surety decides to execute the bond with SBA's guarantee, it forwards to SBA the contractor's application along with underwriting information such as the applicant's experience and financial position. SBA reviews the information and approves or disapproves the bond guarantee.

SBA can approve a bond guarantee only if the following conditions are met:

- The party seeking the bond is a small business concern under the existing size standards.
- The bond is required in order for the party to bid on or perform the contract.
- The bond is not otherwise obtainable under reasonable terms and conditions.
- The applicant can be reasonably expected to perform as required by the contract.
- The contract meets requirements established by SBA for feasibility of successful completion and reasonableness of cost.
- The terms and conditions of the bond are reasonable in light of the risk involved and the extend of the surety's participation.

The surety company pays SBA a guarantee fee of 20 percent of its bond premium.

In the event of default by the contractor, the surety company is obligated to complete the contract. All claims are processed through SBA's central office. The SBA Guarantee Agreement specifies that the surety shall take charge of all claims matters arising under the bonds, determine its liability, compromise, settle, or defend any claim or suit, and take such action as it deems necessary to minimize loss. The surety has the right to recover any losses it sustains from the contractor. In addition, SBA must reimburse the surety for its unrecovered losses, up to the level of Federal guarantee.

It is clear that without SBA's Surety Bond Guarantee Program, an untold number of viable, small business contractors would not be able to operate and compete. Since the inception of the program in 1971, through February 1, 1982, the Agency has guaranteed bonds on 142,039 contracts with a value of approximately $10.8 billion.

There have been substantial problems with SBA's management of this program and the Committee is insisting that SBA tighten up its underwriting procedures and claims handling to insure that the program is not taken advantage of and abused.

The Committee held oversight hearings in 1980, and intends to hold a follow-up review of the Agency's administration of the surety program on March 11, 1982.

In order to continue to assist viable contractors who need the program, and thereby save the government money through the resulting increased competition, the Committee agreed to maintain the Surety Bond Guarantee program level at the current law level of $1.2 billion through Fiscal Year 1987.

BUSINESS LOAN AND INVESTMENT FUND

Small businesses today are facing a crisis. Interest rates are too high, and affordable capital is simply not available. In such difficult economic times, the Federal Government should be maintaining its total assistance to small business, not decreasing it.

The Guaranteed Lending program has been a proven creator of new private sector jobs. Guaranteed loans to promising small businesses are an investment that regularly provide returns not only to the business, but to the entire community in which it is located, in the form of new jobs and economic revitalization.

On February 23, 1982, the Committee held a hearing on the President's Fiscal Year 1983 budget recommendations. The witnesses who testified documented the substantial benefits provided by all of the SBA guaranteed programs, in particular, and addressed the critical need for their continuation at their current funding levels.

In testimony at the hearing, one witness noted that the SBA "section 7(a)" loan program has guaranteed $22.4 billion in loans from 1953 through December 1981, and that the default rate has been relatively low. Furthermore, 112,200 jobs created through the program were created at a cost per job of only $2,375. It was also emphasized that the "section 7(a)" loans carry market interest rates for the borrower. The Guaranteed Loan program is not a subsidized assistance program.

With respect to the Small Business Investment Company program (SBIC), the Committee learned of two separate cost-benefit studies prepared by the accounting firm of Deloitte, Haskins and Sells. The first study found that the Federal Government spent $4 million on the SBIC program in 1970: half was for the cost of administering the program and the other half was SBA's losses on its loans to SBICs. In return for that $4 million, however, the Federal Government received a total of $440 million from increased taxes paid by SBICs, their portfolio companies, and their employees -- a 110 to 1 benefit-cost ratio.

The second phase of the Delóitte, Haskins and Sells 1981 study analyzed the cost of creating a job through the SBIC program. It found that the cost to the Federal Government of each permanent job created in private businesses was a mere $270.

Testimony revealed that the nature of the Minority Enterprise Small Business Investment Company (MESBIC) program is also impressive in its ability to maximize private sector participation in the economy. In 1980, $42 million of MESBIC's funds were invested in minority businesses, which generated an additional $84 million of private financing. Of the total $126 million, only $22 million represented leverage funds from SBA, providing a cost-benefit ratio of almost 1 to 6. When taxes, potential reduced unemployment costs, and other relevant factors are taken into consideration, the final cost-benefit ratio is almost 1 to 40 -- an efficiency rate few other government programs are able to achieve.

A newer program, designated specifically to provide long-term, subordinate debt for the fixed asset expansion needs of growing smaller businesses, is SBA's Section 503 Certified Development Comapny program. This program has been operative for approximately 10 months and has met tremendous demand for long-term debt capital by growing small businesses. In that time period, over 200 development companies submitted applications to participate and 260 loans have been approved totaling approximately $40 million.

It is argued that reductions in SBA lending activities will help to reduce the Federal Government's intrusion into the credit markets. The Committee notes that the impact of total SBA loans on the credit budget is minimal and any further reductions, beyond which were achieved last year, would be counterproductive. As the testimony indicated, the Guaranteed Lending programs have been cost-effective and proven job-creators. In light of this track record, current law levels for the Business Loan and Investment Fund are recommended.

POLLUTION CONTROL EQUIPMENT CONTRACT GUARANTEES

By amendments in 1976 to the Small Business Investment Act of 1958, Congress authorized the Small Business Administration to guarantee one hundred percent of the payments due from eligible small businesses under qualified contracts for the planning, design, financing or installation of pollution control facilities or equipment mandated by governmental pollution control regulations.

The Committee has extensively reviewed this program: a May 1981, oversight hearing, and testimony received by the Committee at its February 23, 1982 review of the President's Fiscal Year 1983 budget, reconfirmed that this is one of the most successful Small Business Administration programs.

Since the 1976 initiative, there has not been a single loss in the program. The initial $15 million capital contribution to the Pollution Revolving Fund has more than doubled through fees charged for guarantees, and investments of idle funds.

The Congress has recognized the sound financial basis for this program, as well as the crucial gap it fills in making financing available to eligible small businesses for mandated, non-productive, pollution control equipment. For example, in Reconciliation (P.L. 97-35), the Congress increased the maximum guarantee level for this program to $250 million. During the Senate's consideration of the Commerce, Justice Appropriations Act (H.R. 4619), the Senate agreed to an amendment offered by two Committee Members to establish minimum commitments for this program.

However, in January 1982, the Small Business Administration announced that, for the balance of Fiscal Year 1982, and for Fiscal year 1983, the Agency would limit its guarantee commitments to $150 million. In addition, the Agency announced that none of the guarantee authority would be used for guaranteeing contracts financed with tax-exempt financing vehicles.

The Committee intends to restate its support for an adequate Fiscal Years 1982 and 1983 program level for the Pollution Control Bond program, and to permit a modest growth in the maximum program level in Fiscal Years 1984 and 1985.

Furthermore, the Committee views the continued availability of the guarantee of contracts financed with tax-exempt financing instruments to be equally important. Repeated testimony of small businesses, bankers, underwriters, and state pollution control financing agencies overwhelmingly demonstrates the importance of small businesses' continued access to this small, but crucial source of guarantee authority.

DEBT COLLECTION

One of the key components of the Small Business Administration's net budget authority requests for Fiscal Year 1983 is an increase in the Agency's debt collection efforts. With a total outstanding direct and guaranteed business loan and

investment portfolio of almost $13 billion, and an outstanding disaster loan portfolio of $6.4 billion, it is obvious that an aggressive debt collection effort can create a significant positive cash flow for SBA, and the Federal Government.

The Committee fully concurs in and supports the Agency's efforts. The Committee has devoted a significant portion of several recent hearings to reviewing the status of the Agency's lending portfolios, and the opportunities and efforts to collect them.

For example, in May 1981, the Committee reviewed the Disaster Loan program, identifying areas of duplicate SBA/ Farmers Home Administration farm disaster loan payments. As a result of those hearings, the Committee unanimously proposed statutory reforms in the SBA Disaster Loan program, including an increase in certain interest rate charges, and limitations on eligibility. The SBA and Department of Agriculture Inspectors General have undertaken a bi-agency computer match of disaster loan recipients to identify multiple loan recipients. Recently, with the support of the Office of Management and Budget, SBA detailed 99 employees to the Southeastern regional office (the region with among the Nation's highest outstanding farm disaster loan portfolios) to intensify farm loan collection.

In October 1981, during the Committee's oversight hearings on the SBA Direct Loan program, the Committee carefully reviewed the current status of direct loan liquidations and collections. On March 11, 1982, the Committee will undertake a detailed review of the underwriting criteria, and claims processing techniques, in the Surety Bond Guarantee program.

But while the Committee is encouraging the Agency's aggressive debt collections efforts, under the Fiscal Year 1983 budget plan, the President has included receipts from debt collection efforts that, in the Committee's view, appear extremely optimistic. For example, the Fiscal Year 1983 budget estimate for debt collection for the business loan and investment fund is $110 million higher than SBA's past collection efforts.

These significant increases in Agency receipts, particularly in the business loan fund, relieve a great deal of pressure on the Agency's net budget authority for the BLIF revolving fund. The Committee believes it is necessary to point out that, to the extent actual debt collections fall short of projections, pressures will be put on the Agency to squeeze the already reduced available discretionary funds, or on Congress to increase budget authority for the Agency to operate its programs.

SMALL BUSINESS ADMINISTRATION
FEDERAL CREDIT ACTIVITIES
(In Millions of Dollars)

	FY 81 Actual	FY 82 Cur Law	FY 83	FY 84	FY 85	FY 86	FY 87
Business Loans	$3,569.2	$3,525	$3,525	$3,525	$3,525	$3,525	$3,525
Direct & Immed. Partic.	392.9	225	225	225	225	225	225
Guaranteed	3,176.3	3,300	3,300	3,300	3,300	3,300	3,300
Pollution Equipment Contract Guarantees	100.0	250	250	250	250	250	250
Total Agency Before Disaster	$3,669.2	$3,775	$3,775	$3,775	$3,775	$3,775	$3,775
Direct	392.9	225	225	225	225	225	225
Guaranteed	3,276.3	3,550	3,550	3,550	3,550	3,550	3,550
Direct Disaster Loans	1,522.1	680	710	780	830	885	936
Total Agency	$5,191.3	$4,455	$4,485	$4,555	$4,605	$4,660	$4,711
Direct	1,915.0	905	935	1,005	1,055	1,110	1,161
Guaranteed	3,276.3	3,550	3,550	3,550	3,550	3,550	3,550

SMALL BUSINESS ADMINISTRATION

BUDGET ACCOUNTS

(In Millions of Dollars)

		FY 81 Actual	FY 82 Cur Law	FY 83	FY 84	FY 85	FY 86	FY 87
Salaries & Expenses	BA	$ 231.9	$221.9	$225.4	$225.4	$225.4	$225.4	$225.4
	O	229.1	239.3	231.2	225.4	225.4	225.4	225.4
Business Loan and Investment Fund	BA	609.0	326.0	408.0	394.0	377.0	364.0	368.0
	O	574.4	475.0	448.0	446.0	435.0	432.0	439.0
Pollution control contract guarantee	BA	-0-	-0-	-0-	-0-	-0-	-0-	-0-
	O	-10.3	-7.0	-8.0	-8.0	-8.0	-8.0	-8.0
Surety bond guarantees	BA	30.0	19.0	19.0	19.0	19.0	19.0	19.0
	O	15.4	33.2	23.5	19.0	19.0	19.0	19.0
Lease guarantees	BA	4.0	3.0	7.0	-0-	-0-	-0-	-0-
	O	3.2	3.9	3.0	2.0	1.0	1.0	1.0
Total Agency Before Disaster	BA	$ 874.9	$569.9	$659.4	$638.4	$621.4	$608.4	$612.4
	O	811.8	744.4	697.7	684.4	672.4	669.4	676.4
Disaster Loan Fund	BA	325.0	-0-	21.0	135.0	188.0	241.0	295.0
	O	1,100.7	114.0	59.0	127.0	146.0	191.0	241.0
Total Agency	BA	$1,199.9	$569.9	$680.4	$773.4	$809.4	$849.4	$907.4
	O	1,912.5	858.4	756.7	811.4	818.4	860.4	917.4